



October 17, 2007

Mr. David Ikari, Chief
Dairy Marketing Branch
California Department of Food and Agriculture
560 J Street, Suite 150
Sacramento, CA 95814

RE: October 10th – 11th Class 4a and 4b Hearing -- Post Hearing Brief

Mr. Hearing Officer and Members of the Hearing Panel:

California Dairies, Inc. appreciates the opportunity to submit the following post-hearing brief to amplify portions of our testimony presented in Sacramento on October 10, 2007 and to attempt to address the questions asked by members of the Hearing Panel.

f.o.b. Price Adjuster for Butter

At the hearing, several witnesses advocated using more than 24 monthly observations to calculate the f.o.b. price adjusters for butter and Cheddar cheese. The lead proponent, the Dairy Institute, proposed using data as far back as 2001 up through August 2007, commenting that the longer time period would give more stability to the calculated figures. However, what was ignored in their reasoning is that transportation costs make up the majority of the embedded costs for the “Chicago Mercantile Exchange – California prices received” difference. Furthermore, the cost of moving finished product to customers has increased significantly since 2001. The Panel need not look any further than the proliferation of hearings on transportation allowances and transportation credits and resulting increases for hauling rates since 2001 to grasp the magnitude of the recent increases in transportation costs. Consequently, the Dairy Institute’s proposal begs the question – of what value is price or cost data that is six years old to this process if transportation costs have only increased and not decreased, as can be verified by the Department’s own data? It seems axiomatic to suggest that when evaluating costs that are essentially monotonically increasing, the most relevant and indicative data is the most recent data. As stated in our testimony, there are far larger issues to address with the current methods for calculating the f.o.b. price adjusters without further complicating matters by using information that is irrelevant to current transportation costs and will bias the results of the f.o.b. price adjuster calculation. Lastly, we point out that using 24-months of data to perform the calculation has been defended by the Panel in the past: “The 24-month method of compiling data by the Department staff provides the most objective information available on California Cheddar cheese and Grade AA butter sales.” (see Panel Report from the June 2006 hearing).

Prior to the hearing, CDI proposed an alternative method for performing the f.o.b. price adjuster calculation. The method that we suggested can be (and has been) applied to the monthly price data that has been collected and is only a slight modification of the method that has been used historically. It has the major benefit of accounting for monthly variations in volume of product sold. It also has the advantage over previously suggested methods of not using plant volume data twice, an approach that the Panel has found to be objectionable, as noted in the Panel Reports from the February 2005 and June 2006 hearings. In short, the new approach satisfies CDI's repeated requests to use an approach that recognizes monthly sales volume fluctuations and simultaneously addresses the Department's reluctance to use a weighting procedure that might bias the estimator by using volume data twice. We urge the Department to adopt the results from applying our proposed method to the Department's data, and to adopt the method itself until the Department and the dairy industry can resolve the issues of what constitutes the best data and what constitutes the most appropriate analytical method to capture accurately the true underlying difference of the prices received by California butter and Cheddar cheese processing plants and the CME prices. We look forward to participating in these discussions with the Department.

Plant Capacity Credit Authority

At the hearing, the witness from the Dairy Institute questioned whether or not the Department had the authority to implement a plant capacity credit, as proposed by California Dairies and attempted to discredit our proposal by citing §61805 (b) of the Food and Agricultural Code, which states, in part, that:

“In determining minimum prices to be paid producers by handlers, the director shall endeavor under like conditions to achieve uniformity of cost to handlers for market milk within any marketing area.”

The witnesses failed to include the remainder of §61805 (b), which goes on to state that:

“However, no minimum prices established or determined under this chapter shall be invalid because uniformity of cost to handlers for market milk in any marketing area is not achieved as a result of the minimum producer prices so established or determined.”

Clearly, the plant capacity credit is not contradictory to §61805 (b), as was stated by the witness from Dairy Institute, because §61805 (b) permits differences in raw product costs among handlers within the same marketing area.

Members of the Panel highlighted several sections of the Food and Agricultural Code (§62074.5, §62077 and §62707(h)) as providing authority to implement other programs administered by the Department. The Panel questioned whether or not the Department had the authority to

implement a plant capacity credit, as proposed by California Dairies. Upon review of the code sections mentioned, we are satisfied that no specific authorization is required to implement and administer a plant capacity incentive program. Fortification allowances and transportation credits do exist, and yet, they are not specifically authorized in the Food and Agricultural Code. Those functions exist under general statutory authority.

Both the Stabilization and Marketing Act and Milk Pooling Act give the Secretary broad discretion regarding pricing and related matters. It was the intent of the Legislature that the powers conferred in the pertinent chapters of the Food and Agricultural Code be liberally construed. The Acts are intended as broad policy guidelines, and not every detail of how to administer the dairy programs will be spelled out in the Food and Agricultural Code. Simply, the Secretary may adopt provisions that effectuate the purposes of the statutes and that are consistent with Department policy. Notwithstanding this, general statutory authorization is provided in §61805(d), which states that the purpose of chapter is, in part, to:

“Enable the dairy industry, with the aid of the state, to develop and maintain satisfactory marketing conditions, bring about and maintain a reasonable amount of stability and prosperity in the production of market milk, and provide means for carrying on essential educational activities.”

Many of the witnesses who testified at the hearing surmised that not having adequate processing capacity in the State has led to disorderly marketing of milk. It is difficult to imagine that any of those witnesses could truthfully state that implementing a program that rewards those companies who choose to invest in new plants or to expand existing plants is inconsistent with the notion of developing and maintaining satisfactory marketing conditions. It seems plain to us that the Department does, in fact, have the authority necessary to adopt and administer a plant capacity incentive program.

Thank you for allowing us the opportunity to submit this post-hearing brief.

Sincerely,



Dr. Eric M. Erba
Sr. VP Producer and Government Relations